COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

ADJUSTMENT OF RATES OF LICKING VALLEY RURAL ELECTRIC COOPERATIVE CORPORATION TO PROVIDE ADEQUATE REVENUES FOR ITS OPERATIONS) CASE NO. 8447

O R D E R

On January 29, 1982, Licking Valley Rural Electric Cooperative Corporation ("Licking Valley") filed with the Commission an application requesting authority to increase its revenue by $486,016 annually, or 6.47 percent, effective March 15, 1982. Licking Valley stated that the proposed rate adjustment was required to meet the increased costs of operation, to continue to provide safe, reliable service to its members, and to maintain sufficient earnings ratios to meet the mortgage requirements of its primary lenders. Based on the determination herein, Licking Valley has been granted an increase in revenue of $334,509 annually, or 4.45 percent.

On April 2, 1982, the Commission suspended the proposed rate increase until August 15, 1982, in order to conduct public hearings and investigations into the reasonableness of the proposed rates. A hearing was scheduled for June 8, 1982, and Licking Valley was directed to give notice to its consumers of the proposed rates and the scheduled hearing.

On February 5, 1982, the Consumer Protection Division in the Office of the Attorney General moved to intervene in this proceeding pursuant to KRS 367.150(8), which motion was granted. No other parties appeared to formally intervene herein.

COMMENTARY

Licking Valley is a consumer-owned rural electric cooperative engaged in the distribution and sale of electric energy to approximately 11,300 member-consumers in the Kentucky counties of Breathitt, Lee, Magoffin, Menifee, Morgan and Wolfe. Licking Valley purchases all of its power from East Kentucky Power Cooperative, Inc.

TEST PERIOD

Licking Valley proposed and the Commission has accepted the 12-month period ending October 31, 1981, as the test period for determining the reasonableness of the proposed rates. In utilizing the historic test period, the Commission has given full consideration to appropriate known and measurable changes.

VALUATION

Net Investment

Licking Valley proposed a net investment rate base of $10,187,910. The Commission concurs with this determination with the following exceptions:

In accordance with past policy, the Commission has adjusted materials and supplies to reflect the 13-month average rather than the year-end balance proposed by Licking Valley. Likewise, prepayments have been adjusted to reflect the 13-month average as the

Commission is of the opinion that such an adjustment provides greater recognition of the changing conditions in which a utility operates. Licking Valley included as working capital one-eighth of pro forma operation and maintenance expenses including other deductions. The Commission has excluded other income deductions from the determination of working capital inasmuch as this expense is a non-operating, "below-the-line" expense.

The rate base has been reduced by $175,855 to eliminate the balance in customer advances for construction at the end of the test year. The Commission is of the opinion that these advances are the equivalent of contributions of capital until their final disposition and should be treated as such for rate-making purposes.

Based on the Commission's adjustments, Licking Valley's net investment rate base for rate-making purposes is as follows:

Utility Plant in Service	$ 12,733,406
Construction Work in Progress	225,772
Total Utility Plant	$ 12,959,178
Add:	
Materials and Supplies	$ 302,238
Prepayments	44,870
Working Capital	152,905
Subtotal	$ 500,013
Deduct:	
Depreciation Reserve	$ 3,263,825
Customer Advances for Construction	175,855
Subtotal	$ 3,439,680
Net Investment	$ 10,019,511

Capital Structure

The Commission finds from the evidence of record that Licking Valley's capital structure at the end of the test year was $10,806,265 and consisted of $3,528,012 in equity and $7,278,253 in long-term debt. In the determination of this capital structure, the Commission has excluded accumulated capital credit assignments from Licking Valley's wholesale power supplier in the amount of $505,406.

REVENUES AND EXPENSES

Licking Valley proposed several adjustments to revenues and expenses to reflect more current and anticipated operating conditions. The Commission finds the proposed adjustments are generally proper and acceptable for rate-making purposes with the following modifications:

Donations

During the test year, Licking Valley spent $129 for public relations advertising through donations to educational and civic organizations. The Commission is of the opinion that expenditures of this type produce little, if any, benefit to Licking Valley's consumers and, therefore, should not be allowed for rate-making purposes.

Depreciation

Licking Valley proposed an adjustment of $16,378 to normalize depreciation expense based on the level of plant in service at the end of the test period. This adjustment does not reflect depreciation on transportation equipment and, therefore has been accepted for rate-making purposes. However, other adjustments are necessary due to Licking Valley's use of improper depreciation rates on transportation equipment. During the test year, Licking Valley accrued depreciation on several vehicles at an annual rate of 33.3 percent. The median depreciation rate for transportation equipment recommended by the Rural Electrification Administration ("REA") in REA Bulletin 183-1 is 18 percent. While Licking Valley has properly allocated these depreciation charges to clearing accounts, it offered no support for the use of depreciation rates in excess of the rates recommended by REA, which had not been approved by this Commission.

The Commission has determined that clearing accounts expense should be reduced for rate-making purposes by $7,576 to reflect a depreciation rate of 18 percent. Furthermore, the Commission is of the opinion and finds that Licking Valley should make the proper accounting adjustments for future depreciation on those vehicles which have been depreciated at an annual rate of 33.3 percent. These adjustments will be in accordance with generally accepted accounting principles, specifically the applicable requirements for changes in estimates.

Interest on Long-Term Debt

Licking Valley proposed an adjustment of $45,264 to annualize interest expense on long-term debt based on the amount of debt outstanding at the end of the test period. However, in calculating the adjustment Licking Valley applied incorrect interest rates to the outstanding balances of two long-term notes held by the National Rural Utilities Cooperative Finance Corporation ("CFC"). After determining the proper interest rates of 11 and 8 percent, respectively, CFC notes C-03, in the amount of $131,794, and C-07, in the amount of $538,103, the Commission has reduced the proposed adjustment by $2,782 to reflect the proper amount of interest on long-term debt.

Interest on Short-Term Debt

During the test year Licking Valley incurred $57,137 in expense for interest on short-term debt. Prior to 1981, Licking Valley's annual interest on short-term debt had never exceeded $30,000 and for the 12 months ended May 31, 1982, Licking Valley has incurred only $21,801 in interest expense on short-term debt. The Commission is aware of the fluctuating nature of short-term borrowings and the record high interest rates incurred by Licking Valley during the test year; nevertheless, we find the test year level of interest on short-term debt to be extraordinarily high. Furthermore, Licking Valley presented no evidence to indicate that the test year level of expense could be expected to recur. The Commission is of the opinion that an adjustment is necessary to reflect a more normal level of interest expense on short-term debt. Therefore, Licking Valley's interest on short-term debt has been reduced by $23,048 to $34,089 which is the average amount of interest on short-term debt incurred by Licking Valley during the 3 most recent calendar years. In this instance the Commission is of the opinion that such an average, based on historical data, will most accurately reflect a normal level of expense.

Fuel Clause

In Case No. 8075 the Commission adjusted Licking Valley's base rates to roll in the fuel cost of its wholesale power supplier. In addition to the roll-in of current fuel costs, the Commission revised the method of calculating the monthly fuel adjustment charge to allow for over- and under-recoveries of the preceding month's fuel charge or credit. This revision will allow total recovery (or refund) of fuel adjustment charges or credits through the fuel adjustment clause. Therefore, the Commission has decreased revenue by $174,908 and decreased purchased power expense by $191,074 to exclude the fuel revenue and cost incurred during the test year in the determination of normalized revenue and power cost.

Purchased Power Flow-Through

The Commission has increased Licking Valley's normalized operating revenue by $609,864 to reflect the increased rates granted Licking Valley in Case No. 8415-L to flow through the increase in the cost of purchased power from East Kentucky Power Cooperative, Inc. In addition, Licking Valley's normalized power cost has been adjusted by $606,370 to reflect the increased cost resulting from the rate adjustment granted to East Kentucky Power Cooperative, Inc., in Case No. 8400.

The effect of the revised pro forma adjustments on net income is as follows:

	Actual Test Period	Pro Forma Adjustments	Adjusted Test Period
Operating Revenues	$7,230,913	$ 988,723	$8,219,636
Operating Expenses	6,654,243	1,050,043	7,704,286
Operating Income	$ 576,670	$ (61,320)	$ 515,350
Interest on Long-Term Debt	331,735	42,482	374,217
Other Income and (Deductions) - Net	$ (33,791)	$ 23,048	$ (10,743)
Net Income	$ 211,144	$ (80,754)	$ 130,390

REVENUE REQUIREMENTS

The actual rate of return on Licking Valley's net investment rate base established herein for rate-making purposes was 5.76 percent. After taking into consideration the accepted pro forma adjustments, Licking Valley would realize a rate of return of 5.14

percent. The Commission is of the opinion that the adjusted rate of return is inadequate and a more reasonable rate of return would be 8.48 percent. In order to achieve this rate of return, Licking Valley should be allowed to increase its annual revenue by approximately $334,509 which would result in a TIER of 2.25. This additional revenue will provide a net income of $464,899 which should be sufficient to meet the requirements in Licking Valley's mortgages securing its long-term debt.

RATE DESIGN AND REVENUE ALLOCATION

Licking Valley did not propose any changes to its existing rate design but it did propose to increase the customer charge within each rate class by approximately 32.7 percent and increase the demand charges by approximately 6.4 percent. Licking Valley's witness, Mr. Gevedon, testified that most of the revenue increase should be allocated to the customer charge to bring the rates more in line with the cost of service.[1] However, Licking Valley presented no evidence concerning the cost of service as it relates to revenue allocation. The Commission is of the opinion that the revenue allocation method proposed by Licking Valley should not be accepted. The Commission is of the opinion and finds that increases of approximately equal percentages for energy, demand and customer charges within each of the rate classes are reasonable, in this instance, as a means of allocating the additional revenue granted herein.

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(1) Transcript of Evidence, June 8, 1982, page 31.

SUMMARY

The Commission, having considered the evidence of record and being advised, is of the opinion and finds that:

1. The rates in Appendix A are the fair, just and reasonable rates for Licking Valley and will produce gross annual revenue sufficient to pay its operating expenses, service its debt, and provide a reasonable surplus for equity growth.

2. The rates proposed by Licking Valley would produce revenue in excess of that found to be reasonable herein and, therefore, should be denied upon application of KRS 278.030.

IT IS THEREFORE ORDERED that the rates in Appendix A be and they hereby are approved for service rendered by Licking Valley on and after August 15, 1982.

IT IS FURTHER ORDERED that the rates proposed by Licking Valley be and they hereby are denied.

IT IS FURTHER ORDERED that within 30 days from the date of this Order Licking Valley shall file with the Commission its revised tariff sheets setting out the rates approved herein.

Done at Frankfort, Kentucky, this 12th day of August, 1982.

PUBLIC SERVICE COMMISSION

Marlin M. Volz
Chairman

Katherine Randall
Vice Chairman

Dyke Carrigan
Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 8447 DATED AUGUST 12, 1982

The following rates and charges are prescribed for the customers in the area served by Licking Valley Rural Electric Cooperative Corporation. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the date of this Order.

SCHEDULE A
FARM AND HOME SERVICE*

Rate:

Customer charge per delivery point	$ 4.75	Per Month
Energy charge per KWH	.05425	Per KWH

SCHEDULE B
COMMERCIAL AND SMALL POWER SERVICE*

Rate:

Customer charge per delivery point	$11.07	Per Month
Energy charge per KWH	.06148	Per KWH

A demand charge of $3.27 per KW in excess of 10 KW.

SCHEDULE B-1 - PERMANENT INSTALLATIONS
COMMERCIAL AND SMALL POWER SERVICE*

Rate:

Customer charge per delivery point	$11.07	Per Month
Energy charge per KWH	.05138	Per KWH

A demand charge of $3.27 per KW in excess of 10 KW.

SCHEDULE B-2
ALL ELECTRIC SMALL POWER SERVICE PERMANENT INSTALLATIONS*

Rate:

Customer charge per delivery point	$ 4.75	Per Month
Energy charge per KWH	.05425	Per KWH

SCHEDULE E
SERVICE TO SCHOOLS, CHURCHES AND COMMUNITY HALLS*

Rate:

Customer charge per delivery point	$ 4.75	Per Month
Energy charge per KWH	.05425	Per KWH

SCHEDULE LP
LARGE POWER SERVICE*

Rate:

Customer charge per delivery point	$44.27	Per Month
Energy charge per KWH	.04951	Per KWH

A demand charge of $3.27 per KW

SCHEDULE LPR
LARGE POWER RATE*

Rate:

Customer charge per delivery point	$85.04	Per Month
Energy charge per KWH	.04253	Per KWH

Demand charge of $3.27 per KW

SCHEDULE SL
SECURITY LIGHTS AND/OR RURAL LIGHTING*

Rate:

Service for the unit will be unmetered, and will be a 175 Watt Mercury Vapor type @ $5.54 each, per month.

*Fuel Adjustment Clause

All rates are applicable to the Fuel Adjustment Clause and may be increased or decreased by an amount per KWH equal to the fuel adjustment amount per KWH as billed by the Wholesale Power Supplier plus an allowance for line losses. The allowance for line losses will not exceed 10% and is based on a twelve-month moving average of such losses. This Fuel Clause is subject to all other applicable provisions as set out in 807 KAR 5:056.